Kensington Energy Ltd.

1999 Annual Report

CORPORATE PROFILE

Kensington Energy Ltd. is a junior oil and gas company with operations concentrated in central and northwest Alberta. We focus our efforts on generating drilling opportunities based on producing analogies in western Canada which can lead to significant reserve and production additions for the Company. Kensington's Class A shares and Class B shares trade on the Canadian Venture Exchange under the trading symbols KNN.A and KNN.B respectively.

ANNUAL MEETING

The Annual General Meeting of Shareholders will be held at 3:00 p.m. on June 14, 2000 in the Cardium Room of the Calgary Petroleum Club located at 319 - 5th Avenue S.W., Calgary, Alberta. Shareholders are encouraged to attend and those unable to do so are requested to complete and return their proxy form at their earliest convenience.

TABLE OF CONTENTS

ABBREVIATIONS

bbls	barrels
bbl/d	barrels per day
bcf	billion cubic feet
boe	barrels of oil equivalent (1)
mboe	thousand barrels of oil equivalent
boe/d	barrels of oil equivalent per day
mbbl	thousand barrels
mcf	thousand cubic feet
mcf/d	thousand cubic feet per day
mmcf	million cubic feet
mmcf/d	million cubic feet per day
NGLs	natural gas liquids

(1) Natural gas is equated to oil on the basis of: 10,000 cubic feet or 10 mcf = 1 barrel of oil equivalent

HIGHLIGHTS

Financial	1999	1998	% CHANGE
Petroleum and Natural Gas Sales	$1,548,808	$1,495,921	4
Cash Flow from Operations	$914,617	$509,547	79
Per Class A Share (Basic)	$0.17	$0.09	89
Per Class A Share (Fully-diluted) [2]	$0.08	$0.04	100
Net Income (Loss) [1]	$333,397	($3,250,177)	n/a
Per Class A Share (Basic)	$0.06	($0.58)	n/a
Per Class A Share (Fully-diluted) [2]	$0.03	($0.58)	n/a
Prices			
Oil and NGLs (per bbl)	$24.73	$22.25	11
Natural Gas (per mcf)	$3.05	$1.78	71
Barrels of Oil Equivalent (per boe)	$25.32	$21.03	20
Operating Netbacks (per boe)	$20.01	$15.44	30
Capital Expenditures (net of Dispositions)	$883,816	$547,855	61
Debt (net of Working Capital)	$1,717,602	$1,620,967	6
Debt / Trailing Cash Flow Ratio	1.88	3.18	(41)
Net Asset Value per Class A Share (PV15)			
Fully-diluted [2]	$0.56	$0.50	12
Class A Shares Outstanding (Year End)			
Basic	5,177,276	5,559,276	(7)
Fully-diluted [2]	11,499,276	12,350,943	(7)
Closing Price	$0.21	$0.25	(16)

Operating			
Production			
Oil & NGLs (bbl/d)	150	142	6
Natural Gas (mmcf/d)	0.17	0.53	(68)
Barrels of Oil Equivalent (boe/d)	167	195	(14)
Proved Reserves			
Oil & NGLs (bbls)	314,000	328,000	(4)
Natural Gas (mmcf)	911	121	653
Barrels of Oil Equivalent (boe)	405,100	340,100	19
Probable Reserves			
Oil & NGLs (bbls)	552,000	676,000	(18)
Natural Gas (mmcf)	3,455	1,240	179
Barrels of Oil Equivalent (boe)	897,500	800,000	12
Established Reserves [3]			
Oil & NGLs (bbls)	590,000	666,000	(11)
Natural Gas (mmcf)	2,639	741	256
Barrels of Oil Equivalent (boe)	853,850	740,100	15
Established Reserve Additions (boe)	174,923	178,675	(2)
Finding and Onstream Costs per Established BOE	$5.05	$3.07	64
Recycle Ratio	3.95	5.06	(22)
(operating netback / finding and onstream costs)			
Drilling Activities			
Gross Wells	1.0	3.0	(67)
Net Wells	0.4	1.9	(79)

[1] The loss for 1998 includes a ceiling test writedown of oil and gas properties of $2,630,000.
[2] Includes conversion of Class B shares into Class A shares.
[3] Established reserves are proved + 50% probable reserves.

MESSAGE TO THE SHAREHOLDERS

At the beginning of 1999, oil prices were very low which resulted in reduced cash flow and reduced capital expenditure budgets for Kensington and the entire industry. In this environment, the Company's goals were as follows:

- keep costs low
- strengthen the Company's financial position
- and resume growth once oil prices recovered.

As the following points illustrate, these goals were achieved:

- ongoing general and administrative expenditures were reduced by 46% in 1999
- the Company's ratio of net debt:operating cash flow decreased from 3.18 at year-end 1998 to 1.88 at year-end 1999
- and progress was made towards growing the Company once again:
  - ➢ two successful wells were drilled at year-end including a new pool oil discovery in central Alberta
  - ➢ proved reserves were added in three new areas
  - ➢ additions to Kensington's land base were made in selective areas and the prospect inventory was increased.

A follow-up well to the new pool oil discovery will be drilled after spring break-up, at which time we will be in a better position to determine the impact of this discovery on the Company. Kensington has a good land base around the discovery and several more wells may be drilled here if warranted by results from the second well.

Increased drilling is required to add to the Company's reserves and production and to generate additional cash flow. Our goal is to have four or more wells drilled in 2000 on Company lands (including wells drilled through farmouts), compared to two in 1999.

Last year witnessed a remarkable recovery in oil prices with WTI staging a recovery from around US$12.00 per bbl early in the year to over US$26.00 by the end of 1999. Oil and natural gas prices have been strong to date in 2000. These strong prices will be an important factor in allowing Kensington to move into a more active drilling mode.

On behalf of the Management and the Board,

Kevin McLachlan

Kevin McLachlan
President

April 26, 2000

EXPLORATION AND OPERATIONS

Since the Company's inception, Kensington's growth philosophy has been to develop a large number of drilling opportunities, each of which can lead to significant reserve and production additions for the Company. We focus on quality oil and gas reservoirs with significant reserve potential and avoid a strategy of short term, unsustainable production gains.

The Company limits the amount of risk capital invested in any single prospect or attempts to have the prospect evaluated by a drilling commitment from an industry partner. This strategy exposes the Company to the potential upside from a large number of exploration and exploitation prospects. The Company has an extensive, high quality prospect inventory and significant undeveloped land base which contain substantial growth opportunities for the Company.

The most significant activities during 1999 in the Company's core areas are described below.

Tomahawk

This area hosts a number of different prospective horizons from Mississippian reservoirs at 1750 meters depth to shallow Belly River reservoirs at 900 meters depth. In 1999, Kensington developed several prospects in this area, the first of which was drilled in December. This well, in which Kensington holds a 37.5% working interest, discovered a new oil pool. The discovery well has been on production since late January 2000 and currently produces 60 to 70 bbl/d of oil. Further drilling will be required to determine the size of this discovery and the next well is slated to spud shortly after spring break-up. Pending the results of the second well, the Company has identified a number of development wells to be drilled in 2000. Kensington currently has a an interest in 8.75 sections of land surrounding this prospect at an average working interest of 37%, and has access to 12 sections of three dimensional seismic data in the area.

In addition to this discovery, Kensington has identified a number of other exploration and development prospects in the area and is continuing its efforts to acquire prospective lands for future drilling.

Highvale

In May, Kensington re-activated and tied-in a suspended Ostracod oil well, which currently produces approximately 30 boe/d. The Company participated in this operation for a 40% working interest.

Kensington continued to build its Highvale land base and now holds an average 54% working interest in 4.9 sections of land. This acreage contains an exploitation project targeting oil in the

Ostracod formation. Past drilling and completion techniques used on this formation have caused damage to the productive zone and Kensington believes that underbalanced horizontal drilling will unlock significant oil reserves on the prospect.

Cherhill / Ste. Anne

In December, Kensington had a natural gas discovery drilled on its acreage in this area. The Company is currently in a royalty position, but will retain a 6.25% working interest after payout of the well. This well is currently producing approximately 1.9 mmcf/d of natural gas. Kensington has other lands in this area on which it has identified seismic anomalies similar to the discovery well and will be working towards having a well drilled in this area in 2000.

Nipisi

Kensington holds an average 87% working interest in 11.5 sections of land in this area and is continuing to acquire land on prospects that have been identified by seismic data. The Company has several Gilwood oil prospects on this acreage and is continuing to develop a land position on a multi-zone shallow gas play. Work is proceeding towards having a well drilled at Nipisi next winter.

Giroux Lake

Activity at Giroux Lake was more limited in 1999 than in previous years. Of note was the December tie-in of the solution gas produced here which was previously flared.

Reserves and Present Value

The table below summarizes the results of an independent engineering evaluation of the Company's reserves prepared by Martin & Brusset Associates as of January 1, 2000.

As of January 1, 2000					Present Value ($000s) before Income Taxes Discounted at			
Reserves (before royalties)	Oil (mbbl)	NGLs (mbbl)	Pipeline Gas (mmcf)	Total (mboe)	0%	10%	12%	15%
Proved Producing	300	6	219	328	5,635	4,132	3,925	3,654
Proved Non-Producing	-	9	692	78	1,361	610	532	440
Total Proved	300	14	911	405	6,996	4,742	4,457	4,094
Probable	481	71	3,455	897	13,294	5,950	5,244	4,412
Total Proved + Probable	781	85	4,366	1,303	20,291	10,692	9,701	8,505
Total Proved + 50% Probable	541	50	2,639	854	13,643	7,717	7,079	6,300

Net Asset Value

	December 31, 1999	
Assets	**Reserve Value @ 10%**	**Reserve Value @ 15%**
(all numbers in thousands except per share data)		
Reserves (proved + 50% probable value)	$7,717	$6,300
Undeveloped Land [1]	1,317	1,317
Working Capital	(317)	(317)
Proprietary Seismic and Other Assets	400	400
Option Proceeds	108	108
Total Assets	9,225	7,808
Liabilities		
Long Term Debt	(1,400)	(1,400)
Net Asset Value	$7,825	$6,408
Fully-diluted Class A Shares Outstanding [2]	11,499	11,499
Fully-diluted NAV Per Class A Share [2]	$0.68	$0.56

(1) Valued at $125 per hectare.
(2) Includes conversion of Class B shares into Class A shares.

Reconciliation of Changes in Reserves

The following table provides the changes in Kensington's reserves from December 31, 1998 to December 31, 1999.

	Oil & NGLs (mbbls)			Pipeline Gas (mmcf)		
	Proved	Probable	Total	Proved	Probable	Total
December 31, 1998	328.0	676.0	1,004.0	121.0	1,240.0	1,361.0
Discoveries during 1999	36.8	117.0	153.8	755.8	2,013.0	2,768.8
Production during 1999	(54.9)	-	(54.9)	(63.1)	-	(63.1)
Divestments during 1999	-	-	-	(7.0)	(5.0)	(12.0)
Acquisitions during 1999	-	-	-	-	-	-
Revision of prior estimates	4.1	(241.0)	(236.9)	104.3	207.0	311.3
December 31, 1999	314.0	552.0	866.0	911.0	3,455.0	4,366.0

Finding and Onstream Costs

	Total	1999	1998	1997	1996	1995[1]
Finding Costs						
Land and acquisitions	$2,015,667	$125,028	$337,709	$504,634	$714,799	$333,497
Property dispositions	(1,324,985)	(91,384)	(1,233,601)	-	-	-
Seismic and geological	1,529,532	15,034	84,840	553,236	422,684	453,738
Drilling and completion	9,435,363	427,876	623,192	4,397,591	3,385,613	601,091
Capitalized G&A	1,684,523	201,183	470,732	357,786	459,823	194,999
Furniture and Equipment	65,976	(531)	(1,683)	46,073	22,117	-
	13,406,076	677,206	281,189	5,859,320	5,005,036	1,583,325
Onstream Costs						
Well equipping	658,518	46,265	154,947	385,085	51,008	21,213
Gathering	376,497	51,176	4,361	97,221	209,140	14,599
Facilities	689,603	109,169	107,358	473,076	-	-
	1,724,618	206,610	266,666	955,382	260,148	35,812
	$15,130,694	$883,816	$547,855	$6,814,702	$5,265,184	$1,619,137
Established Reserve Additions (proved + 50% probable boe)	1,160,528	174,923	178,675	9,939	783,795	13,196
Finding & Onstream Costs (per boe)	$13.04	$5.05	$3.07	$685.65	$6.72	

(1) For the 5 months ended December 31, 1995.

Kensington utilized its capital efficiently in the years 1999, 1998 and 1996 to add new reserves. In 1997 the Company made significant capital expenditures which resulted in very small reserve additions – this has resulted in high cumulative finding and onstream costs. However, these cumulative finding and onstream costs have declined from $16.98 per established boe at year-end

1997 to $13.04 at the end of 1999. An important goal of the Company is to have these costs continue to decline in 2000.

Drilling Activity

Although the Company's drilling activity was low during 1999, the drilling of two new prospects late in the year has yielded positive results. Kensington drilled a new oil pool discovery in December and has acquired a significant land position around this prospect. A successful gas well was also drilled on a second prospect in which Kensington farmed-out its interest.

Kensington continued to add to its prospect inventory through the acquisition of new land and seismic in 1999. This will lead to further drilling locations during 2000, the first of which will spud after spring break-up.

It is anticipated that four or more wells (including wells drilled through farmouts) will be drilled on Kensington lands in 2000.

Undeveloped Land

Kensington's undeveloped land position decreased slightly during 1999 due to dispositions by the Company in areas where no further work was planned. Land acquisition did continue in the Company's core areas of Tomahawk, Highvale and Nipisi where the most immediate drilling opportunities are seen. A summary of Kensington's undeveloped land position at year end is set out below:

	1999	1998
Gross acres	59,050	61,952
Net acres	26,342	28,230
Average working interest	44.6%	45.6%

MANAGEMENT'S DISCUSSION & ANALYSIS

The following discussion and analysis is a review of the financial and operating results of Kensington Energy Ltd. for 1999 and 1998 and should be read in conjunction with the audited financial statements and related notes in this annual report.

Petroleum and Natural Gas Sales

Revenue from petroleum and natural gas sales increased by 4% from $1,495,921 in 1998 to $1,548,808 in 1999. Although production decreased by 14% from 195 boe/d in 1998 to 167 boe/d in 1999, average prices received per boe increased by 20% from $21.03 in 1998 to $25.32 in 1999.

A breakdown of revenue by product is shown in the table below:

	1999		1998	
Product	Total	Per BOE	Total	Per BOE
Oil	$1,327,954	$24.99	$1,102,462	$23.41
Natural Gas	192,172	30.50	341,614	17.76
NGLs	28,682	17.73	51,845	12.38
Total	$1,548,808	$25.32	$1,495,921	$21.03

Royalties and Alberta Royalty Tax Credit

Royalties to the Crown, freehold owners and third parties for 1999 were $282,869 ($4.62 per boe) compared to $148,799 in 1998 ($2.09 per boe). Higher Crown royalty rates in 1999 than in 1998 resulted in higher royalty rates per boe and higher total royalties in 1999. During 1999, $126,660 ($2.07 per boe) was recovered under the Alberta Royalty Tax Credit program compared to $44,931 ($0.63 per boe) in 1998.

Interest and Other Income

Interest and other income increased to $15,272 in 1999 from $5,163 in 1998.

Production Expenses

Production expenses were $168,581 ($2.76 per boe) in 1999 compared to $293,790 ($4.13 per boe) in 1998. Total production expenses decreased in 1999 due to a 33% decrease in production expenses per boe and a 14% decrease in total production from 1998 to 1999. Production expenses continue to be low on a per boe basis due to the high quality of the Company's production.

General and Administrative

General and administrative (G&A) expenditures are set out in the table below:

	1999	1998
Total General and Administrative Expenditures	$410,192	$953,633
Less Capitalized as Part of Petroleum and Natural Gas Properties	(201,184)	(470,732)
General and Administrative Expense	209,008	482,901
Per Boe	$3.42	$6.79

Total G&A expenditures decreased in 1999 for two reasons:

- additional expenditures of $193,135 ($2.72 per boe) were incurred in 1998 responding to a hostile takeover bid – these expenditures would have been $760,498 without the additional costs
- staffing and space costs were reduced in late 1998 and maintained at the lower levels in 1999.

Consistent with full cost accounting, Kensington capitalizes those costs that are applicable to exploration and development activities which amounted to $201,184 in 1999.

Interest Expense

Interest expense was $115,665 during 1999, comparable to the $110,978 of interest expense incurred in 1998.

Depletion, Depreciation and Amortization

	1999		1998	
	Total	per Boe	Total	per Boe
Depletion	$543,523	$8.89	$1,084,383	$15.25
Depreciation	13,703	0.22	18,652	0.26
Site Restoration	23,994	0.39	26,689	0.37
Total	$581,220	$9.50	$1,129,724	$15.88

Total depletion, depreciation and amortization (DD&A) expense in 1999 was lower than in 1998 due to a 40% decrease in DD&A expense per boe and lower production.

Writedown of Oil and Gas Properties

The Company applies an annual ceiling test to the net book value of property and equipment to ensure that this value does not exceed the estimated future net revenue (revenue net of royalties, production expenses, general and administrative costs, financing costs, estimated future site restoration and abandonment costs and income taxes) from production of proved reserves plus the lower of cost and estimated fair market value of unproved properties.

No ceiling test writedown was required in 1999. The ceiling test writedown was $2,630,000 in 1998. The Company calculated the 1998 ceiling test writedown using a December 1998 WTI oil price of US$11.31 per barrel.

Deferred Income Taxes

No deferred income tax provision was required in 1999 or 1998.

Net Income and Cash Flow From Operations

Net income in 1999 was $333,397 compared to a loss of $3,250,177 in 1998. Most of the loss in 1998 was due to the ceiling test writedown of $2,630,000. The net income of $333,397 in 1999 was due to higher revenue and lower expenses in the areas of production, G&A and DD&A.

Cash flow from operations increased by 79% to $914,617 in 1999 from $509,547 in 1998 as a result of the same factors which increased net income in 1999.

BOE Analysis

The following table analyzes operating netbacks, cash flow from operations and net income on a boe basis.

	1999	1998
Petroleum and Natural Gas Sales	$25.32	$21.03
Royalties	(4.62)	(2.09)
ARTC	2.07	0.63
Production Expenses	(2.76)	(4.13)
Operating Netback	$20.01	$15.44
Interest and Other Income	0.25	0.07
General and Administrative (1)	(3.42)	(6.79)
Interest Expense	(1.89)	(1.56)
Cash Flow from Operations	$14.95	$7.16
DD&A	(9.50)	(15.88)
Writedown of Oil and Gas Properties	-	(36.98)
Net Income	$5.45	($45.70)

(1) In 1998, G&A expenses were increased by $2.72 per boe due to additional costs incurred responding to a hostile takeover bid.

Capital Expenditures

Capital expenditures for 1999 were $975,200 ($883,816 net of property dispositions) compared to $1,781,456 ($547,855 net of property dispositions) in 1998. The Company increased net capital expenditures in 1999 to approximately match the level of 1999 cash flow from operations.

The following table provides a comparative analysis of capital expenditures for 1999 and 1998.

	1999	1998
Land and Acquisitions	$125,028	$337,709
Seismic and Geological	15,034	84,840
Drilling and Completion	427,876	623,192
Capitalized G&A	201,183	470,732
Well Equipping	46,265	154,947
Gathering	51,176	4,361
Facilities	109,169	107,358
Furniture and Equipment	(531)	(1,683)
	$975,200	$1,781,456
Property Dispositions	(91,384)	(1,233,601)
Net Capital Expenditures	$883,816	$547,855

Liquidity and Capital Resources

Sources of funds in 1999 were cash flow from operations of $914,617, a decrease in non-cash working capital of $658,594 and proceeds from property dispositions of $91,384. Funds from these sources were used to finance capital expenditures of $975,200, repay long term debt of $430,000, increase cash by $131,959 and repurchase shares for total consideration, including costs, of $127,436.

Sources of funds in 1998 were funds from operations of $509,547, an increase in long term debt of $940,000 and proceeds from property dispositions of $1,233,601. Funds from these sources were used to finance capital expenditures of $1,781,456, repurchase shares for total consideration, including costs, of $96,925 and to reduce the Company's working capital deficiency by $804,769.

Kensington had a $2,000,000 credit facility in 1999 and 1998.

Business Risks

Exploring for, acquiring, developing, producing and marketing oil and natural gas involve a number of business risks and uncertainties which have the potential to significantly affect operating and financial results. These include exploration risk, reservoir performance, commodity prices, competition and government regulation.

Exploration risk relates to Kensington's ability to economically find and develop new reserves. This risk is mitigated by using skilled and experienced employees and consultants, focusing exploration efforts in areas in which we have existing knowledge and expertise, using the latest technologies and controlling costs to maximize profitability. In addition, the Company undertakes a significant portion of its exploration activities jointly with industry partners to spread exploration risk over a larger number of wells.

Forecasted production from oil and gas reservoirs may decline more quickly than anticipated, resulting in lower cash flow and lower reserve recovery. In an effort to mitigate this risk, Kensington focuses on exploring for high quality reservoirs with more predictable decline characteristics.

The prices that Kensington receives for oil, natural gas and NGLs are volatile and subject to a number of external factors over which we have no control. World oil prices are affected by global supply and demand balances, political stability, the actions of OPEC and economic conditions in the major oil consuming countries. Gas prices are affected by supply and demand balances in North America, the availability of pipeline transportation and prices for competing fuels. Kensington will endeavor to hedge a portion of its production at certain times in order to eliminate some pricing risk.

Kensington's activities are all currently in Western Canada. Competition for petroleum and natural gas leases and drilling prospects can be very strong at certain times in certain areas. Kensington attempts to mitigate this risk by avoiding areas where it believes that the economics of oil and gas production would be significantly reduced by intense competition.

The operations of oil and gas producers are subject to extensive controls and regulation by various levels of government, and there is risk that changes in government policies and regulations could adversely impact Kensington's operations.

MANAGEMENT'S REPORT

Management is responsible for the integrity and objectivity of the information contained in this annual report and for the consistency between the financial statements and other financial and operating data contained elsewhere in the report. The accompanying financial statements have been prepared by management in accordance with accounting principles generally accepted in Canada using estimates and careful judgement, particularly in those circumstances where transactions affecting a current period are dependent upon future events. The accompanying financial statements have been prepared using policies and procedures established by management and reflect fairly the Company's financial position, results of operations and its cash flows and changes in financial position, within reasonable limits of materiality and within the framework of the accompanying policies outlined in the notes to the financial statements.

Management has established and maintains a system of internal control which is designed to provide reasonable assurance that assets are safeguarded from loss or unauthorized use and the financial information is reliable and accurate.

The financial statements have been examined by external auditors. Their examination provides an independent view as to management's discharge of its responsibilities insofar as they relate to the fairness of reported operating results and financial condition of the Company.

The Audit Committee of the Board of Directors has reviewed in detail the financial statements with management and the external auditors. The financial statements have been approved by the Board of Directors on the recommendation of the Audit Committee.

Kevin McLachlan

Kevin McLachlan
President

March 23, 2000

AUDITORS' REPORT

To the Shareholders of Kensington Energy Ltd.

We have audited the balance sheets of Kensington Energy Ltd. as at December 31, 1999 and 1998 and the statements of income (loss) and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these financial statements present fairly, in all material respects, the financial position of Kensington Energy Ltd. as at December 31, 1999 and 1998 and the results of its operations and its cash flows for the years then ended in accordance with accounting principles generally accepted in Canada.

Ernst & Young LLP

Calgary, Canada
March 20, 2000

Chartered Accountants

Kensington Energy Ltd.
Incorporated under the laws of the Province of Alberta

BALANCE SHEETS

As at December 31

	1999 $	1998 $
ASSETS ***[note 3]***		
Current		
Cash	**5,028**	—
Accounts receivable	**627,967**	500,998
	632,995	500,998
Property and equipment ***[note 2]***	**4,283,463**	3,956,872
	4,916,458	4,457,870
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current		
Bank indebtedness	—	126,931
Accounts payable and accrued liabilities	**950,597**	165,034
	950,597	291,965
Long term debt ***[note 3]***	**1,400,000**	1,830,000
Site restoration and abandonment provision	**83,648**	59,653
Commitment and contingency *[notes 6 and 9]*		
Shareholders' equity		
Share capital *[note 4]*	**6,271,683**	6,399,119
Deficit	**(3,789,470)**	(4,122,867)
	2,482,213	2,276,252
	4,916,458	4,457,870

See accompanying notes

Approved by the Board:

Ian Collar

Director

Kevin McLachlan

Director

Kensington Energy Ltd.

STATEMENTS OF INCOME (LOSS) AND DEFICIT

For the years ended December 31

	1999 $	1998 $
Revenue		
Petroleum and natural gas sales	**1,548,808**	1,495,921
Royalties	**(282,869)**	(148,799)
Alberta royalty tax credit	**126,660**	44,931
Interest and other income	**15,272**	5,163
	1,407,871	1,397,216
Expenses		
Production	**168,581**	293,790
General and administrative *[note 2]*	**209,008**	482,901
Interest on long term debt	**115,665**	110,978
Depletion, depreciation and amortization	**581,220**	1,129,724
Writedown of oil and gas properties *[note 2]*	—	2,630,000
	1,074,474	4,647,393
Net income (loss) for the year *[note 5]*	**333,397**	(3,250,177)
Deficit, beginning of year	**(4,122,867)**	(872,690)
Deficit, end of year	**(3,789,470)**	(4,122,867)
Net income (loss) per Class A share *[note 4]*		
Basic	0.06	(0.58)
Fully diluted	0.03	(0.58)

See accompanying notes

STATEMENTS OF CASH FLOWS

For the years ended December 31

	1999 $	1998 $
Operating activities		
Net income (loss) for the year	**333,397**	(3,250,177)
Add non-cash items		
Depletion, depreciation and amortization	**581,220**	1,129,724
Writedown of oil and gas properties	**—**	2,630,000
Cash flow from operations	**914,617**	509,547
Changes in non-cash working capital *[note 8]*	**430,270**	(388,454)
	1,344,887	121,093
Financing activities		
Increase (decrease) in long term debt	**(430,000)**	940,000
Shares repurchased and cancelled	**(127,436)**	(96,925)
	(557,436)	843,075
Investing activities		
Additions to property and equipment	**(975,200)**	(1,781,456)
Proceeds on sale of petroleum and natural gas properties	**91,384**	1,233,601
Changes in non-cash working capital *[note 8]*	**228,324**	(523,771)
	(655,492)	(1,071,626)
Increase in cash (bank indebtedness)	**131,959**	(107,458)
Cash (bank indebtedness), beginning of year	**(126,931)**	(19,473)
Cash (bank indebtedness), end of year	**5,028**	(126,931)
Cash flow from operations per Class A share *[note 4]*		
Basic	0.17	0.09
Fully diluted	0.08	0.04

See accompanying notes

NOTES TO FINANCIAL STATEMENTS

Kensington Energy Ltd. (the "Company") is engaged in the acquisition of petroleum and natural gas rights and the exploration for, development and production of, crude oil and natural gas in Canada.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Property and equipment

Capitalized costs

The Company follows the full cost method of accounting for its oil and gas operations whereby all costs related to the exploration for and the development of petroleum and natural gas reserves are initially capitalized.

Capitalized costs include lease acquisition, geological and geophysical expenditures, lease rentals on non-producing properties, costs of drilling both productive and non-productive wells, equipment costs and a portion of general and administrative expenses that is applicable to these activities.

Proceeds from disposal of properties will normally be applied as a reduction of the cost of the remaining assets unless the disposal results in a change in the depletion rate of greater than 20%, in which case a gain or loss on disposal will be recorded.

Depletion and depreciation

Depletion of petroleum and natural gas properties and depreciation of production equipment is provided for using the unit of production method based on estimated proved petroleum and natural gas reserves before royalties, as determined by independent engineers.

The depletion and depreciation cost base includes total capitalized costs, less costs of unproved properties, plus provision for future development costs of proved non-producing reserves, as determined by independent engineers. Costs incurred for facilities under construction at year end are excluded from the cost base.

The relative volumes of oil and gas reserves and production are converted at a ratio of ten thousand cubic feet of gas to one barrel of oil.

Computer equipment and furniture are carried at cost and are depreciated over the estimated useful lives of the assets at a rate of 25% calculated on a declining balance basis.

Site restoration and abandonment

Estimated future site restoration and abandonment costs are accrued on the unit of production method. Estimates are based on costs and regulations in effect at year end. The annual charge is included in depletion, depreciation and amortization expense and the cumulative annual charge is shown as a non-current liability. Abandonment and site restoration expenditures are charged to the accumulated provision account as incurred.

Ceiling test
The Company applies an annual ceiling test to capitalized costs, net of deferred income taxes and the site restoration provision, to ensure that the net carrying value does not exceed the estimated value of future net revenues from

NOTES TO FINANCIAL STATEMENTS

production of proved reserves less future production, related general and administrative expenses, financing costs, estimated future site restoration and abandonment costs and income taxes, plus the lower of cost and estimated fair market value of unproved properties. Any reduction in value, as a result of the ceiling test, will be charged to operations.

The calculation of future net revenues is based on wellhead prices and costs, and the income tax and Alberta royalty tax credit legislation in effect at year end.

Flow-through shares

The Company has financed the majority of its exploration and development activities through the issue of flow-through shares. Under the terms of the flow-through share issues, the tax attributes of the related expenditures are renounced to subscribers. To recognize the foregone tax benefits to the Company, the carrying value of the properties and the shares issued are recorded net of the tax benefits renounced to subscribers when the expenditures are incurred.

Joint operations

Substantially all of the Company's petroleum and natural gas activities are conducted jointly with others and, accordingly, these financial statements reflect only the Company's proportionate interest in such activities.

Deferred income taxes

The Company follows the deferral method of accounting for income taxes under which the provision for corporate income taxes is based on the earnings reported in the accounts and takes into account the tax effects of timing differences between financial statement income and taxable income.

Financial instruments

Financial instruments of the Company consist of cash, accounts receivable, bank indebtedness, accounts payable and accrued liabilities and long term debt. As at December 31, 1999 and 1998 there are no significant differences between carrying values and estimated market values.

The Company may utilize financial instruments in its management of exposures to fluctuations in commodity prices. Contracts may be used to manage the price risk associated with crude oil sales. Gains and losses on these contracts are deferred and recognized in revenues when the related transactions occur.

Measurement uncertainty

The amounts recorded for depletion and depreciation of oil and gas properties is based on estimates. The ceiling test calculation is based on estimates of proved reserves, production rates, oil and gas prices, future costs and other relevant assumptions. By their nature, these estimates, and those related to the future cash flows and estimated market values used to assess impairment, as well as the carrying value of unproved properties, are subject to measurement uncertainty and the effect on the financial statements of changes to these estimates in future years could be significant.

NOTES TO FINANCIAL STATEMENTS

2. PROPERTY AND EQUIPMENT

	December 31, 1999		
	Cost $	Accumulated Depletion and Depreciation $	Net Book Value $
Petroleum and natural gas properties and production equipment	**11,001,420**	**6,758,800**	**4,242,620**
Computer equipment and furniture	**96,303**	**55,460**	**40,843**
	11,097,723	**6,814,260**	**4,283,463**

	December 31, 1998		
	Cost $	Accumulated Depletion and Depreciation $	Net Book Value $
Petroleum and natural gas properties and production equipment	10,117,604	6,215,809	3,901,795
Computer equipment and furniture	96,303	41,226	55,077
	10,213,907	6,257,035	3,956,872

As at December 31, 1999 property and equipment includes unproved properties of $696,867 (1998 - $987,664) which have been excluded from costs subject to depletion.

The Company applied the ceiling test to the capitalized amounts of petroleum and natural gas properties and production equipment at December 31, 1999, and has determined that no writedown (1998 - $2,630,000) was required.

The Company capitalizes general and administrative charges, net of overhead recoveries, directly attributable to petroleum and natural gas exploration and development. Details are as follows:

	1999 $	1998 $
Total general and administrative expenditures	**410,192**	953,633
Less capitalized as part of petroleum and natural gas properties	**(201,184)**	(470,732)
General and administrative expense	**209,008**	482,901

3. LONG TERM DEBT

As at December 31, 1999, the Company has a $2,000,000 revolving operating line of credit (1998 - $2,000,000), due on demand bearing interest at an effective rate of 7.25%. The bank has indicated that, while it reserves the right to request

NOTES TO FINANCIAL STATEMENTS

payment on demand, they are not aware of any facts, events or occurrences which would cause them to demand the loan prior to December 31, 2000. Accordingly, the loan is classified as long term.

The Company has pledged as collateral a general security agreement and a first floating charge demand debenture over all of the Company's assets. The credit facility will be reviewed by the bank annually.

4. SHARE CAPITAL

Authorized

Unlimited number of Class A common shares, voting, with no par value.
Unlimited number of Class B common shares, voting, with no par value.

Issued and outstanding

	1999		1998	
	Number of Shares	**Consideration $**	**Number of Shares**	**Consideration $**
Class A Shares				
Balance, beginning of year	**5,559,276**	**2,757,850**	4,999,776	2,656,620
Private placement of flow-through shares	—	—	450,000	742,500
Exercise of flow-through exchange rights (a)	—	—	308,000	—
Repurchased and cancelled	**(382,000)**	**(87,000)**	(198,500)	(83,495)
Less: tax benefits related to renounced expenditures (b)	—	—	—	(557,775)
Balance, end of year	**5,177,276**	**2,670,850**	5,559,276	2,757,850
Class B Shares				
Balance, beginning of year	**1,600,000**	**3,641,269**	1,624,000	3,654,699
Repurchased and cancelled	**(94,500)**	**(40,436)**	(24,000)	(13,430)
Balance, end of year	**1,505,500**	**3,600,833**	1,600,000	3,641,269
Share capital, end of year		**6,271,683**		6,399,119

a) In conjunction with the issue of 308,000 flow-through exchange rights on December 23, 1996, the exchange rights were exercised during 1998 for 308,000 Class A shares for no additional consideration.

b) During 1998, the Company incurred the related expenditures and recognized the foregone tax benefits related to issues of flow-through shares in 1998 and 1997 by reducing the carrying value of both the Class A shares and petroleum and natural gas properties by $557,775.

Conversion privileges of Class B shares

The Class B shares will be convertible into a maximum of 6,022,000 Class A shares at the Company's option at any time before June 30, 2000. The fraction of a Class A share obtained upon conversion of each Class B share will be equal to $4.00 divided by the greater of $1.00 or the current market price of the Class A shares at that time. Should the Company fail to exercise the conversion option by June 30, 2000, the Class B shares are convertible, at the option of the shareholder, at any time after July 1, 2000 and before August 31, 2000 into Class A shares. Any Class B shares not converted to Class A shares by August 31, 2000 are deemed to be converted at that time.

NOTES TO FINANCIAL STATEMENTS

Escrowed shares

At December 31, 1999, 158,400 Class A shares are held in escrow to be released on July 20, 2000.

Stock option plan

The Company has established a stock option plan whereby the Company may grant options to its directors, officers and employees for up to 10% of the issued Class A shares. The exercise price of each option equals the closing price of the Company's Class A shares on the date prior to the grant. Stock options vest evenly over the three-year period from the date of grant and expire five years after the date of grant. No compensation expense is recognized when stock options are either issued or exercised.

The following is a continuity of stock options outstanding for which shares have been reserved:

	1999		**1998**	
	Shares	Weighted -Average Exercise Price $	Shares	Weighted-Average Exercise Price $
Opening	**391,667**	**1.17**	372,000	1.53
Granted	**162,000**	**0.20**	201,000	0.55
Exercised	—	—	—	—
Cancelled	**(253,667)**	**1.51**	(181,333)	1.21
Closing	**300,000**	**0.36**	391,667	1.17

The following summarizes information about stock options outstanding at December 31, 1999:

Exercise Price $	Number Outstanding at December 31, 1999	Weighted-Average Remaining Contractual Life (years)	Weighted-Average Exercise Price $	Number Exercisable at December 31, 1999	Weighted-Average Exercise Price $
0.55	**138,000**	**3.33**	**0.55**	**46,000**	**0.55**
0.20	**162,000**	**4.75**	**0.20**	—	—
	300,000	**4.10**	**0.36**	**46,000**	**0.55**

Per Share Amounts

Net income (loss) per Class A share and cash flow from operations per Class A share have been calculated based on the weighted average number of Class A shares outstanding for the year of 5,431,861 (1998 - 5,615,891).

Fully diluted net income (loss) per Class A share and fully diluted cash flow from operations per Class A share have been calculated assuming that the Class B shares were converted into Class A shares at the beginning of 1999 at a rate of $4.00 divided by the greater of $1.00 and the December 31, 1999 closing price of $0.21 (1998 - $0.25).

NOTES TO FINANCIAL STATEMENTS

Proceeds from the exercise of stock options are assumed to have been invested in short term deposits at a pre-tax yield of 3% per annum.

Cash flow from operations per Class A share has been calculated based on cash flow from operations before changes in non-cash working capital.

5. INCOME TAXES

The provision for income taxes is different from the amount computed by applying the combined statutory Canadian Federal and Provincial tax rates to income (loss) before income taxes. The reasons for these differences are as follows:

	1999 $	1998 $
Income (loss) before income taxes	**333,397**	(3,250,177)
Statutory income tax rate	**44.62%**	44.62%
Computed expected tax expense (recovery)	**149,000**	(1,450,200)
Increase (decrease) in taxes resulting from:		
Non-deductible crown charges	**99,500**	43,500
Alberta royalty tax credit	**(56,500)**	(20,000)
Resource allowance	**(66,000)**	(8,000)
Non-deductible depletion	**119,000**	867,800
Recognition of tax benefit of prior year's loss	**(245,000)**	—
Tax benefit of loss carryforward not recognized	—	566,900
Income tax provision	—	—

The Company has available for deduction against future taxable income undepreciated capital cost, Canadian exploration expense, Canadian development expense and Canadian oil and gas property expense aggregating approximately $3,409,000 and non-capital losses of $212,000 which expire in 2005.

6. COMMITMENT

The Company is committed to an operating lease for office premises. Future payments are as follows:

	$
2000	**52,912**
2001	**52,215**
	105,127

7. FINANCIAL INSTRUMENTS AND FINANCIAL RISK MANAGEMENT

The nature of operations and the issuance of debt expose the Company to fluctuations in commodity prices, foreign currency exchange rates and interest rates. The Company manages these risks by operating in a manner that minimizes

NOTES TO FINANCIAL STATEMENTS

its exposure to the extent practical, and through the periodic use of financial instruments. The Board of Directors periodically reviews the results of all hedging activities and all outstanding positions.

Except as described below, the Company does not have any significant concentrations of credit risk nor does it hold any financial instruments with significant off-balance sheet risk of accounting losses.

Petroleum Price Risk Management

The Company manages its exposure to petroleum price risk on its production through the periodic use of financial instruments. The Company has entered into contracts to swap spot prices for fixed prices on 50 barrels per day of its oil production at prices of US $20.05 per barrel for the first quarter of 2000 and US $21.10 per barrel for the second quarter of 2000.

Fair Value of Financial Instruments

The fair value of recognized financial instruments at December 31, 1999 and 1998 approximate their carrying value. The fair value of the unrecognized petroleum price agreements at December 31, 1999 was ($50,963) (1998 - not applicable). The estimated fair value of the agreements is based on public trading values.

8. CHANGES IN OTHER NON-CASH WORKING CAPITAL

	1999 $	**1998** $
Accounts receivable	**(126,969)**	1,006,035
Accounts payable and accrued liabilities	**785,563**	(1,918,260)
	658,594	(912,225)
Attributable to investing activities	**228,324**	(523,771)
Attributable to operating activities	**430,270**	(388,454)

9. YEAR 2000 ISSUE

The Year 2000 issue arises because many computerized systems use two digits rather than four to identify a year. Date-sensitive systems may recognize the year 2000 as 1900 or some other date, resulting in errors when information using year 2000 dates is processed. In addition, similar problems arise in some systems which use certain dates in 1999 to represent something other than a date. Although the change in date has occurred, it is not possible to conclude that all aspects of the Year 2000 issue affecting the Company, including those related to customers, suppliers or other third parties, have been fully resolved.

10. COMPARATIVE FIGURES

Certain comparative figures have been reclassified to conform with the current year's presentation. These financial statements adopt, on a retroactive basis, the Statement of Cash Flows prescribed by the Canadian Institute of Chartered Accountants in place of the Statement of Changes in Financial Position.

HISTORICAL SUMMARY

Financial	1999	1998	1997	1996
Petroleum and Natural Gas Sales	$1,548,808	$1,495,921	$2,904,779	$748,590 (1)
Cash Flow from Operations	$914,617	$509,547	$1,569,866	$483,094 (1)
Per Class A Share (Basic)	$0.17	$0.09	$0.36	$0.13
Per Class A Share (Fully-diluted) (3)	$0.08	$0.04	$0.17	$0.06
Net Income (Loss) (2)	$333,397	($3,250,177)	($1,001,868)	$129,178 (1)
Per Class A Share (Basic)	$0.06	($0.58)	($0.23)	$0.04
Per Class A Share (Fully-diluted) (3)	$0.03	($0.58)	($0.23)	$0.02
Prices				
Oil and NGLs (per bbl)	$24.73	$22.25	$22.90	$29.52
Natural Gas (per mcf)	$3.05	$1.78	$1.69	$2.10
Barrels of Oil Equivalent (per boe)	$25.32	$21.03	$20.08	$28.33
Operating Netbacks (per boe)	$20.01	$15.44	$13.39	$21.12
Capital Expenditures (net of Dispositions)	$883,816	$547,855	$6,814,702	$5,265,184
Debt (net of Working Capital)	$1,717,602	$1,620,967	$1,485,736	-
Debt / Trailing Cash Flow Ratio	1.88	3.18	0.95	-
Net Asset Value per Class A Share (PV15)				
Fully-diluted (3)	$0.56	$0.50	$0.88	$1.36
Class A Shares Outstanding (Year End)				
Basic	5,177,276	5,559,276	4,999,776	3,790,500
Fully-diluted (3)	11,499,276	12,350,943	9,929,776	7,022,340
Closing Price	$0.21	$0.25	$1.45	$2.01

Operating	1999	1998	1997	1996
Production				
Oil & NGLs (bbl/d)	150	142	209	131
Natural Gas (mmcf/d)	0.17	0.53	1.87	0.12
Barrels of Oil Equivalent (boe/d)	167	195	396	143
Proved Reserves				
Oil & NGLs (bbls)	314,000	328,000	387,000	383,000
Natural Gas (mmcf)	911	121	665	1,681
Barrels of Oil Equivalent (boe)	405,100	340,100	453,500	551,100
Probable Reserves				
Oil & NGLs (bbls)	552,000	676,000	248,000	319,000
Natural Gas (mmcf)	3,455	1,240	1,101	1,134
Barrels of Oil Equivalent (boe)	897,500	800,000	358,100	432,400
Established Reserves (4)				
Oil & NGLs (bbls)	590,000	666,000	511,000	542,500
Natural Gas (mmcf)	2,639	741	1,216	2,248
Barrels of Oil Equivalent (boe)	853,850	740,100	632,600	767,300
Established Reserve Additions (boe)	174,923	178,675	9,939	783,795
Finding and Onstream Costs per Established BOE	$5.05	$3.07	$685.65	$6.72
Recycle Ratio (operating netback / finding and onstream costs)	3.95	5.06	0.02	3.14
Drilling Activities				
Gross Wells	1.0	3.0	23.0	27.0
Net Wells	0.4	1.9	8.9	8.7

(1) These financial results are for the 6 months ended December 31, 1996.
(2) The losses for 1997 and 1998 include ceiling test writedowns of oil and gas properties of $840,000 and $2,630,000, respectively.
(3) Includes conversion of Class B shares into Class A shares.
(4) Established reserves are proved + 50% probable reserves.

CORPORATE INFORMATION

OFFICES

850, 700 - 4th Avenue S.W.
Calgary, Alberta
T2P 3J4

Tel: (403) 262-1701
Fax: (403) 261-0603
Email: kensington@home.com

BOARD OF DIRECTORS

Kevin McLachlan
President
Kensington Energy Ltd.

Ian Collar
Vice-President, Exploration
Kensington Energy Ltd.

John Gareau
Independent Businessman

Ronald Quillian
Independent Businessman

AUDITORS

Ernst & Young LLP
Calgary, Alberta

BANKERS

Alberta Treasury Branches
Calgary, Alberta

EVALUATION ENGINEERS

Martin & Brusset Associates
Calgary, Alberta

REGISTRAR AND TRANSFER AGENT

Valiant Corporate Trust Company
Calgary, Alberta

SOLICITORS

Gowling, Strathy & Henderson
Calgary, Alberta

OFFICERS & KEY PERSONNEL

Kevin McLachlan
President

Ian Collar
Vice President, Exploration

Gregory Turnbull
Secretary

STOCK EXCHANGE LISTING

Canadian Venture Exchange

Trading Symbols:

Class A Shares	KNN.A
Class B Shares	KNN.B